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THE PRESENT FRENCH TAX SYSTEM -

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ITS STRENGTHS AND WEAKNESSES

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ITS STRENGTHS AND WEAKNESSES

Submitted by James L. Houghteling, Jr.

1 October 1953

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BRIVE SUMMARY

1. The principal defect of the French tax system is not that it fails to raise sufficient revenues but that the burden of taxation is badly distributed. The total burden is now so heavy that it is doubtful whether, in the absence of a national emergency, significantly higher taxes are either politically feasible or economically advisable.

2. The unfair distribution of the tax burden is not due to the ignorance of tax technicians but to the practical difficulties of making the income taxes, which are the instruments best designed to achieve a fair distribution, work effectively and equitably. The main difficulties are these: (a) Certain occupational groups strongly represented politically (notably farmers) are deliberately relieved of paying their share of taxes by legislative intention; and (b) other groups (notably owners of small and medium-sized business enterprises and professional people) are able systematically to conceal a considerable proportion of their incomes.

3. The weaknesses of the income tax have forced the government to rely heavily on consumption taxes. Despite efforts to prevent these from falling too heavily on low-income groups, these taxes cannot by their nature be made as equitable as effective income taxes would be.

4. The tax system protects small and inefficient economic units and discriminates against the enterprises and processes most likely to raise national productivity.

5. The need for tax reform is universally admitted, but parliamentary agreement on particular measures seems virtually impossible to obtain.

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LONGER SUMMARY

Everybody knows that the French tax system is not working well, but there is considerable confusion as to what is wrong with it.

1. Since the war France has had continual budgetary deficits, which have been responsible in part for the chronic inflation which has done so much to upset the national economic life. There is a tendency to assume that deficits persist, in spite of large amounts of post-war foreign aid, because Frenchmen refuse to pay enough taxes. Actually, however, the burden of taxes (plus social security payments by employers and employees, which are similar to taxes) is close to one-third of gross national product; which is a higher ratio than that for the United States and almost as high as that for the United Kingdom. There are Frenchmen who do not pay enough in taxes, but if means were found to obtain from them their fair share, part at least of the gain therefrom would have to be sacrificed to relieve the oppressive burden now being imposed on others. Although better tax enforcement and tax reforms might increase revenue somewhat, the principal hope for higher revenues lies, not in the tightening of rates, exemptions, etc., but in a rising national income. Better tax yields can contribute something to bringing the deficit down to manageable proportions, but must be accompanied by budgetary economies and higher levels of borrowing from the public. (This is not a rosy prospect, since opportunities for expenditure reductions are hard to find and harder to push through the parliament, while bitter experience has made those French who are able to save reluctant to invest substantial amounts in government bonds.)

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2. The principal defect of the French tax system is that the tax burden is not equitably distributed. The system taken as a whole is probably mildly progressive, but because (a) taxes levied on consumption are so heavily relied on, and (b) some groups are so markedly underassessed under the income taxes, the distribution of the tax burden among taxpayers bears little relation to ability to pay.

3. Consumption taxes yield about 57% of the central government's budgetary receipts (as compared to 22% produced by income taxes.) By far the most important of them is a heavy (basic rate 15.35%) sales tax levied on producers, which is probably the most technically effective of French taxes. There are also a national and a local turnover tax on virtually all commercial transactions, and excises on gasoline, alcohol and alcoholic beverages, meat and some other commodities. The consumption taxes are probably not as inequitable as is sometimes charged, since some effort has been made to take account in setting rates of the importance of commodities and services taxed in the budgets of the lower income groups. Most basic foodstuffs are exempted from the heavy tax levied on producers, and some from the turnover taxes. Indeed, as matters stand, the consumption taxes, unsatisfactory though they are as instruments for taxing according to ability to pay, are probably less inequitable today than are the income taxes.

4. The essential weakness of the income taxes is that incomes are not assessed with uniform accuracy for all categories. Wages, salaries, pensions and income from securities are on the whole accurately reported to the tax authorities. The

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incomes of farmers, small and medium-sized business enterprises and professional people are generally underassessed. Farmers benefit from an extraordinarily favorable assessment system designed by the farm bloc in parliament to ensure that farmers will be taxed lightly. Most small businessmen are assessed under an administrative estimates system which tends to discriminate in their favor, but, along with medium-sized business firms and professional men, they above all are underassessed because their opportunities for fraudulent concealment of income are so great. Larger firms, which for a variety of reasons are much less able to conceal the true magnitude of their earnings, tend to be assessed with increasing accuracy. An effort has been made to lessen the relative overtaxation of wages and salaries by exempting them from one of the income taxes; this step was, however, at best a crude and inadequate method of lessening the inequity of income tax assessment.

5. As the above paragraph suggests, the principal locus of tax evasion is not among the rich but among the owners of small and medium-sized business enterprises. Although rich Frenchmen form no exception to the prevailing pattern of low tax morality, and although some of them are able to evade on a large scale, the significant fact about them is not the extent of their evasion but that they are so few in number, and their combined incomes form so small a portion of the total of personal incomes, that it is simply impossible to extract from them sums sufficient to avoid having to impose heavy taxes on the rest of the population. The real problem of tax burden distribution is not how to "soak the rich" but how to achieve a more equitable distribution among the great mass of small and medium-sized incomes.

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6. The concentration of evasion among the owners of the smaller enterprises presents a dilemma to the tax authorities. In the first place, the task of ascertaining the correct gross receipts and net profits of numberless small businessmen is bound to be relatively unremunerative in proportion to the time and effort spent. Furthermore, tax rates are as high as they are because evasion has been anticipated and discounted: if a real effort were made to make these rates fully effective (to say nothing of collecting back taxes and imposing fines), many small firms would have to go out of business.

7. It is clear that many inefficient marginal enterprises stay in business only because the tax system favors them against their more efficient competitors. By merely collecting the turnover tax from customers and then being able to keep the proceeds by not recording the sale, thousands of small retail establishments manage to stay afloat indefinitely. The whole tax system protects the small (and all too often inefficient) enterprise, and discriminates against bigness, against intergration and against adoption of modern methods. Some examples are the favorable tax treatment of artisans, various raised tax rates applied to chain-stores, and the double taxation of capital equipment under the tax on producers. The discrimination in favor of farmers also plays a part in perpetuating their inefficient production methods. In other words, the economic effects of the French tax system run counter to the constant efforts of the government to raise the nation's productivity.

8. Tax reform is obviously needed to overcome as far as

possible the defects here described, but an effective deadlock arises when reform measures are proposed. Partly, this is the consequence of a clash of interests among those whose respective positions will be altered by any reform. Partly it is a disagreement between the optimists, who want more reliance on income taxes and a diminishing use of traditional estimates procedures, and the pessimists, who feel that consumption taxes must continue to be the heavy-duty taxes, and that income taxes, retained as relatively minor fiscal instruments, should be based on assessments making a maximum use of impersonal, automatic and "scientific" estimates of probable approximate income. A modest reform bill proposed by M. Pinay in 1952 was mutilated by a parliamentary committee before it was finally withdrawn, and there is little reason to believe that other proposals under discussion will fare any better. A dim hope exists that the parliament will in desperation allow a Government to promulgate a limited reform by decree, thus evading responsibility for passing on its provisions.

PREFATORY NOTES

1. The statistics of annual tax yields used herein are mostly those of 1951, because that is the latest year for which the figures are complete and final. The use of 1952 figures would not, however, alter the points made herein in any important respect. In general the legislative and regulatory provisions are described as they were at the end of 1950, since the latest available edition of the General Tax Code is that of 1951. Subsequent changes have been included only when they have come to our attention. However, it is safe to say that no changes of major importance have been made since then.

2. This study gives comparatively few dollar "equivalents" of franc amounts. This is because we are convinced that such comparisons are generally more misleading than useful. Neither the official nor a free- or black-market exchange rate gives a dollar equivalent which makes accurate wage, price and purchasing power comparisons possible. Dollar equivalents are, however, given (at the official rate since 1949 of 350 francs to the dollar to facilitate understanding in a few instances where they seem indispensable.

3. Footnote references are used sparingly, but a complete list of source materials consulted is appended.

Attention must particularly be drawn to a recent publication of unique value: it is entitled Rapports du Service des études économiques et financières du Ministère des Finances sur les comptes provisoires de la nation des années 1951 et 1952 et sur le budget économique de l'année 1953 (1953). (Cited hereafter as Rapports sur les comptes provisoires.) This is the

so-called "Mendes-France Report", popularly named for the former minister because he heads the National Accounts Committee but actually the work of Finance Ministry officials. For the present study, the trenchant analysis of the French economy as of 1951 has been even more useful than the national accounts statistics.

4. The least satisfactory parts of the present study are those concerned with the actual tax practices, as against institutions and legal provisions. Reliable information giving details on such subjects as assessment under the administrative estimates system, verification of declarations, favored methods of avoidance and evasion, and the choice of penalties for fraud is largely unobtainable from books and periodicals. Research inside France, entailing interviews with tax agents, taxpayer advisors and (if possible) certain categories of taxpayers is needed to strengthen this portion of any study of French taxes.

I. Some Basic CharacteristicsA. Why the French Tax System is Important.

The prolonged cabinet crisis of May and June 1953, closely followed by the outbreak of strikes in August, provide new evidence of the serious ailments of the French community. High among the French institutional and other weaknesses receiving renewed attention is the nation's tax system.

Why is French taxation important? In what senses may it be considered a cause of current French difficulties?

(a) Most obvious is the relationship between tax receipts and budgetary difficulties. The inability of the French to eliminate chronic and often large deficits has been one of the causes of the inflationary pressures which have done so much to upset the French economy since the war. At the same time, insufficient receipts prevent the undertaking of public expenditures of vital importance. The global military effort is inadequate, more public housing is urgently needed, the lower grades of soldiers and civil servants are seriously underpaid. This situation prevails, moreover, despite large postwar receipts of American aid. Inevitably the question rises whether Frenchmen are contributing all they might in taxes.

(b) Undoubtedly many of France's difficulties stem from the prevailing lack of civic unity, and particularly from the sense of social injustice which corrodes the morale of the working class. One contributing cause of the hostility between classes and occupational groups has undoubtedly been the inequitable distribution of the tax burden.

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(c) It is probably impossible today to have a tax system which is "neutral" in its economic impact, but governments can and must make sure that detrimental effects on the nation's economic structure and development are kept to a minimum. The French system, however, fosters and protects small economic units and traditional patterns of activity and thereby discourages efficiency and initiative. In doing so, it is counteracting the conscious and declared national policy of lowering costs and prices (domestic and export) and promoting higher levels of productivity.

B. Types of Taxes Levied.

Table 1 indicates the relative importance of the major categories of taxes levied by the French central government. ^{1/}

^{1/} The present study devotes little attention to local taxes, which in 1951 yielded 327 billion francs, or 16% as much as the central government's taxes. The most important of these is a tax similar to the national transactions tax; then come the property taxes, followed by numerous small duties.

Also omitted from this study are the "parafiscal" taxes, which are a weed-like growth of levies earmarked for specific extrabudgetary purposes, collectively of comparatively little importance. Social security payments by employers and employees are sometimes grouped with the parafiscal taxes, although not collected by the tax authorities; they also receive virtually no attention in this study.

The most productive of French taxes are those levied on sales: these are (a) the production tax, levied on producers and on services, the basic rate of which for commodity transactions is currently 15.35%; and (b) the transactions tax, levied on virtually all commercial transactions, of which the basic rate is 1%. Next in importance are the income taxes, consisting of a proportional tax (basic rate 18%), a progressive surtax (rates running from 10 to 70%), and a corporate income tax with a basic rate of 34%. These two groups of taxes, which together produce roughly 70% of the central government's tax

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Table 1

BUDGETARY RECEIPTS OF THE CENTRAL GOVERNMENT IN 1951
(by official category, showing principal taxes under each)

	<u>Billions of francs</u>	<u>% of total tax receipts</u>
Direct Taxes	<u>678.5</u>	<u>32.7</u>
(a)		
<u>Income Taxes</u>		
Proportional tax	132.2	6.4
Progressive surtax	111.0	5.4
Corporation tax	217.6	10.5
Payroll-Pensions tax	164.9	8.0
<u>Sales Taxes</u>	<u>1007.7</u>	<u>48.6</u>
Production tax	808.4	39.0
Transactions tax	199.3	9.6
<u>Excise Taxes</u>	<u>51.8</u>	<u>2.5</u>
Taxes on alcohol	40.3	1.5
<u>Registry Duties</u>	<u>106.8</u>	<u>5.2</u>
Transfers for consideration	32.0	1.5
Death and gift duties	28.6	1.4
<u>Stamp Duties</u>	<u>17.1</u>	<u>0.8</u>
<u>Other Taxes</u>	<u>5.8</u>	<u>0.3</u>
<u>Customs</u> (includes internal taxes on oil products, 147.)	<u>204.1</u>	<u>9.9</u>
<u>Total tax receipts</u>	<u>2071.8 (b)</u>	<u>100.0</u>
<u>Other budgetary receipts</u>	<u>441.8</u>	
<u>Total Budgetary Receipts</u>	<u>2513.6</u>	

Source: Ministère des Finances, Statistiques et études financières, January 1953, pp. 49-58.

(a) For explanations of income tax figures, see Table 2.

(b) Roughly \$6 billion at the current official rate of exchange.

receipts, will be discussed in greater detail hereafter.

Little need be said of the other taxes. The important tax on payrolls and pension funds is related to the income tax, and will be discussed in that context. Of the excise taxes, by all odds the most remunerative are the taxes on petroleum products. The various taxes on alcohol and alcoholic beverages have been the subject of much controversy because of the political power and sensitivity of the producers affected, but they are not now and are unlikely to become major producers of revenue. The so-called registry taxes, levied on the occasion of the recording of a large variety of documents, raise a number of problems. The most important of them fall on certain types of property transfers, either gratuitous (gifts and inheritances) or for consideration. They tend to be much evaded, but their effective imposition in the instances where evasion is impossible may in some cases have a detrimental effect on the improvement of real property and on business growth.

The Finance Ministry has estimated that roughly 57% of the receipts of the central government's budgetary receipts in 1951 represented levies on consumption, with taxes on income representing only about 22%. Taxes on capital (notably the property transfer duties), having declined in importance over the years, now represent less than 6%.^{2/}

^{2/} Ministère des Finances, Secrétariat d'Etat au Budget, Le budget de 1952 (1952), p.13. For earlier years, see Ministère des Finances, Inventaire de la situation financière (mise à jour faite en 1951 de l'inventaire de 1946) (1951), pp.41, 260-262. To establish the ratio between the taxes on income and on consumption, some fairly arbitrary decisions on classification are required. For instance, the payroll tax (7% of budgetary receipts) is administratively classified with the income taxes, but some economists call it a tax on consumption. It is here arbitrarily excluded from both the 57% and the 22% figures. The Ministry calculation of total consumption taxes used for this comparison include not only the sales and excise taxes and customs receipts but also that part of the receipts of the State monopolies (notably of tobacco and matches) which enter the central budget. This is justified on the ground that the prices of these products include an element of tax.

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The heavy reliance of the French on consumption taxes is often criticised. In contrast to the French 22%, the United States in 1952 obtained 83% of federal tax revenues from income taxes.^{3/} (The comparable British figure is slightly over

^{3/} This comparison would be more useful if it were possible to include in it taxes levied by other levels of government. The striking difference in ratios would remain, but the ratios would probably be somewhat less far apart.

50%.) The small role of French income tax receipts is in large part a consequence of their lack of success over the last thirty-five years in making their income taxes both productive and equitable. It is now generally accepted in France that until there is a revolution in the attitudes of certain categories of taxpayers, including a willingness to abandon traditional legislated privileges, taxes on consumption must be relied on to bear the larger part of the fiscal burden. Unfair as consumption taxes are, they are today less inequitable than are the income taxes.

C. The Total Tax Burden.

Outside of France it is widely believed, largely because of the known extent of tax evasion, that the aggregate burden of French taxes paid must be comparatively light. In fact, the total of national. Local and "parafiscal" taxes, plus payments into social security funds (which must be included both because of their tax-like character and in order to make useful international comparisons) has mounted steadily since 1946, and in 1951 was close to 30% of France's gross national product for that year.^{4/} The corresponding percentage for the ^{4/} Le budget de 1952, pp. 29-31.

United Kingdom was probably somewhat higher, but the comparable American figure would be somewhat lower. When it is remembered that per capita income in France is far smaller than in the United States, the real weight of the French tax burden will be appreciated.

How has so heavy a burden been imposed when evasion is so extensive? ^{5/} The answer is that the government, obliged to

5/ In recent year, taxes evaded are reported to have amounted to something like 25% of taxes collected.

seek ever greater revenues as the level of expenditures rose, during recent years sought and obtained rate increases as long as it was politically possible to do so, and since then has resisted most of the demands for alleviating adjustments in rates and in basic and dependency exemption provisions, justified though these often were because of the monetary depreciation. Thus the tax burden on those unable to evade has become in some instances well nigh intolerable; it would be intolerable for many more taxpayers but for their ability to evade. Revenues are still inadequate, overall inequity and the detrimental economic effects of some taxes are intensified, and meanwhile tax evasion, long since generally immune to social censure, has received renewed justification. The evaders can argue that since the government counts on a certain proportion of evasion, makes allowance for it in setting rates and does not expect the established rates to be fully effective, to make honest declarations would be foolish.

Inevitably, there is continuous pressure on the legislators from many quarters to alleviate the taxes which have become the most oppressive. The indications are that, in spite of the

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need for still higher tax receipts to reduce the deficit, some of the taxes will in fact be lightened in the coming months. But if the tax administration were to discover tomorrow some miraculous means of collecting all the amounts of which it is now being defrauded, the pressure to lower rates and adjust exemptions and deductions would increase a thousandfold. Rather than cause the collapse of numerous marginal enterprises, a considerable portion of the increased receipts made possible by effective enforcement would in all likelihood be sacrificed in the granting of tax relief.

II. The Income Taxes.

Income taxation was introduced in France with the enactment of two laws, in 1914 and 1917. Previous to this, French taxes had consisted of numerous indirect taxes, a tax on dividends and interest, and four traditional direct taxes dating from the Revolution and based respectively on the rental values of land, dwellings and business premises, and on the number of one's doors and windows. This array of tax devices became increasingly unsatisfactory and the enactment of the income taxes was followed by an elimination of the four traditional direct taxes as national fiscal instruments, and subsequently by major changes in the indirect taxes.

The four old direct taxes are worth remembering because from them has stemmed the notion still prevalent in French tax thinking that in the absence of an exact means of ascertaining a taxpayer's income, the quantity and assessed value of selected forms of property owned or used by him can serve as indicia of wealth on the basis of which a tax can be calculated.

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A. The Personal Income Taxes.

It is important to recognize at the outset that the income tax legislation now in force in France is by no means an entirely inept taxing instrument. Much of it is modern in conception. In many respects it is not dissimilar from our own federal income tax. In few instances do the weaknesses of the law stem from bad technical planning or execution; they are almost entirely the result of politically-inspired barriers to just, rational and effective legislative and administrative provisions.

The legislation is complex, and it will only be possible to examine those few features which represent the most striking evidence of the spirit in which it has been enacted, and of why it does not work better.

Today there are two personal income taxes, a proportional tax and a progressive surtax, each of which entails a declaration and payments each year on the previous year's income. As their titles suggest, the proportional tax involves the application of a basic rate (currently 18%) to net taxable income as defined in the statute, while the surtax involves the further application of a series of progressive bracket rates (currently ranging from 10 to 70%) to net taxable income (for this purpose somewhat differently defined).

The surtax has existed (though under a different name until recently) since 1914, but the proportional tax was only inaugurated in 1948; it succeeded a system of six separate "scheduling" taxes. These were levied respectively on income from

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(a) industry and commerce, ^{6/} (b) agriculture, (c) professional

6/ Until 1948, corporations and other juridical persons were taxed the same as if they were physical persons under this schedular tax.

and other noncommercial occupations, (d) wages, salaries and pensions, (e) securities, and (f) land, improved or unimproved. Each tax had its own definitions of taxable income, its own rate or rates, exemptions and deductions.

The adoption of the proportional tax has somewhat diminished the importance of the differentiations between sources of income. But there remain many vestiges of the old compartmentalization, based on the principle that some types of income should be taxed more heavily than others. From a psychological viewpoint, that aspect of compartmentalization which results in the annual publication by the Finance Ministry of tax yield statistics showing breakdowns by categories (see Table 2) is particularly important, since it keeps taxpayers conscious that they are not all being treated alike. Except perhaps for farmers, most lightly taxed of all, there are taxpayers in each category who can find cause for bitterness on discovering how small seem the number of taxpayers in some of the other categories, how low the average of their declared incomes and how insufficient must therefore be their tax contribution. Undoubtedly the distribution of the tax burden among occupational groups in the United States falls far short of perfect equity, but the subject never seems to receive the attention here which it continually receives in France.

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Table 2

TAXPAYERS, TAXABLE INCOMES AND TAX YIELDS UNDER THE INCOME
TAXES IN 1951
(1950 Incomes)

	No. of tax- payers in category (thous.)	Taxable incomes assessed or declared (billion fr.)	Pct. of total in- come assessed under tax %	Yield (billion francs)
<u>Proportional Tax</u>	<u>2048</u> (a)	<u>710.4</u>	<u>100.</u>	<u>132.2</u> (c)
Income from land	420	8.5	1.2	
Industrial and commercial profits	1453 (b)	513.3 (b)	72.3	
Remuneration of managers, etc. (c)	66	43.8	6.2	
Agric. profits	516	71.5	10.1	
Salaries, wages, etc. (d)	7	1.3	0.2	
Professional inc., etc.	122	68.9	9.7	
Interest payments (e)	40	2.8	0.4	
Incs. rec'd outside France; Other (c)	1	0.2	0.1	
<u>Progressive Surtax</u>	<u>2985</u> (a)	<u>1596.0</u>	<u>100.</u>	<u>111.0</u>
Income from land	409	9.8	0.6	
Industrial and com- mercial profits	516	311.7	19.5	
Remun. of managers	48	39.1	2.5	
Agric. profits	53	15.2	1.0	
Salaries, wages, etc.	2517	1090.3	68.3	
Professional inc.	102	61.3	3.8	
Income from securities	757	64.3	4.0	
Income rec'd outside France; Other	16	4.5	0.3	
<u>Corporation tax</u>	(160) (f)	(450) (f)	--	217.6 (g)
<u>Total Income Tax Receipts</u>				<u>460.8</u>

Source: Ministère des Finances, Statistiques et études finan-
cières, October 1952, pp. 877-886.

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Notes to Table 2

(a) The total number of taxpayers shown as paying the proportional tax and surtax, respectively, is smaller than the sum of the numbers of taxpayers shown as having income in each of the income categories, since some taxpayers had income in more than one category.

(b) These are profits of firms not subject to the corporation tax. 1453 thousand taxpayers include 1154 thousand on an estimates basis and 299,000 on a self-assessment basis. (See below in text for explanation.) 513.3 billion francs of taxable income include 301.3 billion earned by firms on an estimates basis, and 212 billion by firms on a self-assessment basis.

(c) Six of the statutory categories of income are offshoots of the old schedular taxes enumerated in the text. A seventh category has been added for the remuneration of corporate officials out of profits. Incomes received outside of France and Other are not separate categories under the law but are given separate headings in the statistics.

(d) As is explained below in the text, nearly all incomes from wages, salaries and retirement pensions have since 1948 been exempted from the proportional tax.

(e) The interest payment income here referred to is a small segment of the taxable income in the securities income category, consisting of income not taxed at the source. The 30 billion francs of taxes collected from the payers of dividends and bond interest appear in the figure for the total yield of the proportional tax, but no information on the number of recipients of this form of income or the amount of such income taxed is included in the statistics.

(f) These figures are given only to show orders of magnitude. The tax statistics for 1951 do not show how many companies paid the corporation tax or what their total taxable earnings were; these figures are estimates, actually based on data on industrial and commercial profits for 1950 in Statistiques et études financières, January 1953, pp.5-13, and May 1953, pp. 421-423.

(g) The figure here given for the yield of the corporation tax includes 196.7 billion francs of part-payments made during 1951 on current estimates submitted of 1951 earnings, plus 20.9 billion francs of year-end final payments made during 1951. (This latter figure, which seems to be provisional, should perhaps be somewhat higher.)

1. Problems of assessment. The most serious difficulties encountered by the French in levying income taxes are probably those relating to income assessment.

Americans are apt to think that there is only one proper way of assessing an income: the taxpayer makes a declaration of his earnings, following instructions provided by the tax authorities, takes advantage of certain exemptions and deductions allowed him, and proceeds to calculate his tax. A sufficient proportion of declarations are investigated to demonstrate to him that it is worth his while to report accurately. The procedure is simplified if his income consists entirely of a wage or salary, since employer declarations and withholding can be used, but the principle is not changed because he is taxed on his actual income as stated in a declaration.

In France, the superiority of the verified self-assessment system is far from being taken for granted. Two alternative systems have long historical antecedents. The first is the indicial system, based on the concept already mentioned that a taxpayer's capacity to pay can be calculated by referring to such external indicia of wealth as the size of his dwelling, number of doors and windows, number of motor vehicles in his possession or servants in his employ. This is obviously a crude system: for example, the bachelor living alone in a large house and the father whose numerous children oblige him to own a home of comparable size pay the same tax. The second system, perhaps best described as the administrative estimates (forfaitaire) system, is a refinement of the first.

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Again the object is not to ascertain a man's exact income but to arrive at an approximation of it by indirect means. External indicia are often used under this system, but the information most relied on is the taxpayer's declaration of his gross receipts from his business or occupation. In its simplest form the estimates system involves the assumption that taxable income is a certain percentage of gross receipts, but generally the assessment is somewhat more complicated: external signs of wealth and economic data on the relative prosperity of different types of enterprise are also used.

Even the best of estimates systems have two defects which seem to be underemphasized by those who favor this type of assessment. In the first place, their justification lies primarily in the notion that declarations of gross receipts, etc., for a given period are easier for the taxpayer to prepare and for the tax agent to verify than are income declarations, and are less apt to involve fraudulent underappraisal. The evidence, however, is that there is considerable fraud in declarations for the estimates systems. Secondly, the use of gross receipts must always be a crude means of arriving at an estimate of income because no account can be taken of variations in costs. If a coefficient to be applied to gross receipts is established which is designed to take account of the average level of costs in a given line of business, there will inevitably be some firms which will be overassessed because of some extraordinary expenditure. To avoid this, the tendency is inevitably to set coefficients so low that few if any firms will be overassessed, although this means that most firms will be underassessed.

The French proponents of the estimates method would probably make two retorts to this line of reasoning. First, they might say that the tax rates are now so high that to be under-assessed is not to be undertaxed. This argument is essentially irrelevant. Second, they would say that to use a verified self-assessment system on the mass of small economic units now taxed under estimates systems is not practical, and that to attempt it would lead to even less satisfactory results than are now obtained. Unfortunately, this is probably true. Given the tax administration's chronic shortage of funds and personnel, the public hostility to real investigation by tax agents, the rudimentary nature of most small enterprise book-keeping, the universality of the practice of concealing assets whenever possible, and lastly the low tax yield in any case per hour of investigative effort, the task of administering a self-assessment system for small enterprises would probably be unrewarding as conditions now stand.

To an American, putting tax assessment on an income declaration basis must seem the goal to be striven for, with estimates systems a poor substitute to be used less and less as taxing and taxpaying practices improve. Many French experts express exactly the opposite view. The estimates principle, they say, is and will remain the best approach to the problem of assessing small business incomes in France. But considering how little is obtainable in taxes under any circumstances from small business, the estimates system should be less costly in administrative time and effort -- and less of a nuisance to the taxpayers - than it now is. The system must be reformed, they conclude, so that it involves less individualization and less reliance on declared information, and makes more use of scientific studies of the earnings of

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representative firms in various lines of business. ^{7/}

^{7/} This attitude is clearly evident in the tax reform bill proposed by the Pinay Government in 1952, no. 4579, Assemblée nationale, Année 1952, Projet de loi portant réforme fiscale (1952); see especially p. 5.

Before one criticizes too freely the slow progress made by the French with their problems of assessment, one should remember that most of the difficulties arise in the assessment of those groups -- farmers, small businesses and professionals -- which are notably hard to tax in all countries, including our own. Fortunately for our tax yields, the aggregate income of these groups forms a far smaller portion of the total income susceptible of taxation in this country than it does in France, so that we are not obliged to worry so much as must the French about the inevitable shortcomings of income taxation in these sectors.

To sum up the current practice with respect to income assessment:

For the taxing of wages and salaries, and of most dividends and interest, the French rely on information returns by the payers of these forms of income and on withholding at the source. The larger business concerns, incorporated or not, are required to make income declarations. Some of those in the liberal professions, and some land-owners are taxed on the basis of income declarations because no estimates system can be devised for them. But for small unincorporated enterprises, farmers, and the other landowners and professional people, estimates methods are used.

A few further details must be given concerning the assessment of the four principal income categories, and assessment for the surtax.

a. Profits of unincorporated industrial and commercial enterprises. The proprietors of enterprises whose annual gross receipts do not exceed 10 or 2.5 million francs (roughly \$28,000 or \$7,000), depending on the type of enterprise, may opt for assessment under the estimates system. In 1951, about 80% of all industrial, commercial and artisanal enterprises subjected to the individual income tax were taxed under this system. Their owners were obliged to declare their gross receipts of the previous year, and to provide information concerning their purchases, inventories, number and total pay of employees, rents paid, motor vehicles owned, etc. On the basis of this material and after discussions with the taxpayer, the tax agent arrived at a figure which was supposed to approximate taxable income. The taxpayer entered this figure under the heading of net industrial and commercial profits on his tax return due somewhat later in the year.

The gross receipts figure is the basic element in the tax agent's calculation; coefficients applied to the other figures supplied provide a means of cross-checking the preliminary estimate. The agent has limited powers of investigation of the data reported to him, and the central administration also provides him with certain statistical material on business trends.

The estimates of total taxable profits in the principal lines of business arrived at under the estimates system are published periodically. Each year the critics of the tax system comment on the ridiculously low incomes shown: all sorts of

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businesses known to be highly profitable are shown as providing their owners with incomes barely above the subsistence level.^{8/}

8/ Out of roughly 1450 thousand industrial, commercial and artisanal units subjected to the proportional tax in 1951, some 1150 thousand were taxed under the estimates system. The total declared income taxed on estimates amounted to roughly 300 billion francs (out of some 510 billion francs of assessed profits in the income category). Thus the average taxable income of these units was 262 thousand francs, which is the rough equivalent of \$745. a year. This seems low even for small business in France. On the other hand, it has been pointed out that, at least up until recently, the ratio between declared income and gross receipts tended to be lower for firms taxed on their declared incomes than for those taxed on estimates. L. Trotabas, Les finances publiques et les impôts de la France (1953), pp. 182-183.

It is reported that many tax agents have become so skeptical about the usefulness of preparing estimates on the basis of coefficients that they simply decide how high an estimate they can impose without encountering too much of an argument and then work out with the taxpayer a rationale of the figure arrived at for the records.

Once established, the estimate may be used year after year unless the taxpayer or the administration calls for its revocation.

b. Agricultural profits. The taxation of agricultural income has been one of the major subjects of tax controversy over the past thirty years. While other groups may not provide accurate information concerning their income, the estimates system for farm income has been so organized that the farmer's tax base is systematically undervalued without any

need on his part to defraud. Actually, the farmers are paying more in income taxes today than they were before the war,^{9/} but

9/ In 1934, a Finance Minister recommended abandonment of the agricultural profits schedule, as not producing enough to warrant the expense involved in maintaining it.

they still pay far less proportionally to their income in money and kind than other taxpaying groups.

The distinctive characteristic of the assessment of farm income is that, instead of endeavoring to determine each farmer's income by self-assessment and verification (which undeniably would be difficult to do accurately, for both farmers and tax agents), or even by estimating on the basis of declared gross receipts or some such figure, an approximation is sought by a variant of the indicial system.

Previous to the 1948 tax reform the assessment of farm profits, like the assessment of income from land, was based on the land valuations contained in the national land survey (cadastre). The last complete survey dated from before the First World War, and so left much to be desired as a basis of reference. The "land-survey income" was multiplied by a coefficient taken from a series negotiated for each département of France or each homogeneous agricultural region and varying according to the relative overall productivity of land in the department or region that year. The income assessments were always extremely low in relation to those of other income groups, since the coefficients negotiated were allowed to rise far slower than price and other statistics indicated they should

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have. Needless to say, such a system took no account of individual variations in farming efficiency.

With the 1948 reform, the use of the survey valuations was largely abandoned for estimating farm profits. Instead the tax authorities, Ministry of Agriculture representatives and the committees of local farmers who formerly had negotiated the coefficients for each department were assigned the task of estimating average net earnings per hectare devoted to each farm product produced in the department or region, using actual price data. Their determinations were published, and the farmer used the published figures to work out his own taxable income, by multiplying the figures applicable to him by the number of hectares which he was recognized to be devoting to each crop.

The new system (of which the preceding is a considerably simplified description) operated as had the old in a manner favorable to the farmers, whose interests were well defended by both the local committees and the Ministry of Agriculture representatives. Yet the assessments rose to such an extent in the first year of the new system over what they had been before that the farm bloc in the parliament felt it necessary to obtain a partial return to the old land survey valuation system for some types of farming operation.

c. Salaries, wages and pensions. While small business, farmer and professional incomes tend to be underassessed, wages, salaries and pensions have long been assessed with a high degree of accuracy. Employers and the payers of pensions are required

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to report these payments to the tax authorities, and until 1948 the proportional tax was collected on them by a withholding procedure.

In 1948 it was decided to exempt most wages, salaries and pensions from the proportional tax and subject them only to the surtax. The reasons for this change were two. Partly, it was the result of a growing realization that these forms of income were being subjected to relatively higher taxation than most other categories (even though the applicable schedular rate was the lowest of the proportional rates) because of the very accuracy of assessment. A more important reason, however, was the need for the government to grant an overdue raise in wages (then State-controlled); a blanket tax exemption provided a means of doing so considered to be less inflationary in its impact than a direct increase would have been.

To recoup the resultant loss of revenue, a new tax was enacted on payrolls (5%) and pension funds (3%), to be paid by employers and payers of pensions.

Wages and salaries (as well as pensions) are still subject to the surtax, and are accurately assessed for that purpose on the basis of employer information returns. (There are at present no withholding provisions under the surtax.) The basic exemption and dependency relief provisions in the surtax are sufficiently high so that most workers now pay no income tax -- which is as it should be, since wage levels are notably low. Salaried employees, however, are subject to the

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steep surtax rates, and it is often averred that, because of the accuracy with which they are assessed, they continue to pay more than their fair share of the income tax, despite their exemption from the proportional tax. It is certainly true that they contribute by far the largest part of the surtax receipts, as Table 2 above shows.

Whether it is concluded that wages and salaries continue to be overtaxed must depend in part on the view taken as to who finally pays the payroll-pension tax. Pricing practices and market conditions in France in recent years have enabled business enterprises to pass on most of the taxes levied upon them, and it does not seem realistic to assume that the payroll tax is largely paid by reducing profit margins. On the other hand, the practice in some quarters of referring to it as in effect a withholding tax, on the ground that in its absence employers would pay correspondingly higher wages, does not seem justified by recent wage movements; many factors beside strictly cost considerations have entered into the determination of French wages in the past few years. It seems most likely that to date the payroll tax has been primarily passed on to consumers. Undoubtedly, however, the level of wages, and employer decisions concerning their use of labor, have been somewhat affected by the existence of the payroll tax.

This is perhaps an appropriate point at which to stress how unsatisfactory a solution to the problem of income tax inequity is the granting of special relief to groups of taxpayers because they are accurately assessed. What becomes of the unfortunate taxpayer who, though belonging to a group

which is normally thought to be underassessed, is himself assessed accurately? He is subject to the artificially high rates, benefits from no special relief, and is the most heavily taxed of all.

d. Income from securities. The proportional tax on securities income is paid, not by the recipient of dividends and interest, but by the distributing company (except when the company is not under French jurisdiction) on the amount of its distributed earnings. Thus evasion by individuals of the proportional tax on income from domestic securities is impossible. There is no collection at the source of the surtax, and the tax authorities must depend on taxpayer declarations, but the tax administration have apparently found methods of keeping concealment of income from domestic securities, at least, to a minimum. (The problem of detecting income earned abroad, is, of course, far more difficult.)

e. Assessment for the surtax. The surtax is based (with certain exceptions) on the same components of income as the proportional tax. But each taxpayer whose income is subjected to the surtax is obliged to declare, in addition to the information required for the proportional tax, the rental value of his residence(s), the number and ages of his employees, and the number and horsepower of his automobiles. Applying the prescribed coefficients to these indicia, the tax agent makes an independent appraisal of the taxpayer's likely income. If the total declared income comes to less than this estimate, the burden of explaining the difference is on the taxpayer. (However, insufficient verification of these declarations of indicia, and coefficients which tend to be too

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low, lessen the real significance of this cross-check.)

2. Rates and Reductions. The basic rate of the proportional tax is 18%. Wages, salaries, pensions and annuities not benefitting from the exemption described above, as well as artisanal and most professional incomes, benefit from a 9% rate for the fraction of taxable income below 200,000 francs.

The taxpayer calculates his tentative proportional tax on the basis of his entire net income. He may be entitled to certain reductions of this initial figure: if his net income is below 60,000 francs (for the 18% rate) or 120,000 francs (9% rate), he finally pays no tax, and if it is only slightly larger, his tentative tax is reduced. There are further reductions for each dependent child. These reductions are extremely meagre.

For computing his surtax, the taxpayer is given the "income-splitting" privilege allowed Americans who make joint returns. But not only the spouse but dependent children as well are included in the split, with each child counting as one-half a unit. Thus a married man with four children, after determining his taxable income, divides that figure by 4, applies the rates applicable to the quotient thus arrived at and multiplies the result by 4.

The rate schedule applicable to 1952 incomes is as follows. Note that the fraction of income (or of the quotient, if there has been splitting) below 180,000 francs is 10/ not taxed.

10/ The surtax contains a provision reducing the tax for low incomes, which works in such a way that an income (or quotient) of 220,000 francs or less is in fact not taxed.

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For the fraction between:

1,000	and	180,000 francs	(\$500.)	no surtax
181,000	and	350,000	" (\$1000.)	10%
351,000	and	600,000	" (\$1,700.)	15%
601,000	and	900,000	" (\$2,600.)	20%
901,000	and	1,500,000	" (\$4,300.)	30%
1,501,000	and	3,000,000	" (\$8,600.)	40%
3,001,000	and	6,000,000	" (\$17,100.)	50 or 55%
Fraction above		6,000,000	"	60 or 70%

(In the last two brackets, the higher rate given is applicable to taxpayers without any dependents.)

3. Impact of the personal income taxes.

Table 3 shows the taxes levied on family units of various sizes and earning various incomes.

The true significance of the tax burdens shown can, of course, only be appraised in the light of such considerations.

Table 3

COMPUTATIONS OF COMBINED PERSONAL TAXES FOR VARIOUS FAMILIES AND INCOMES UNDER CURRENT RENT RATES
(in thousands of francs)

(S for single) (M for married)	Taxable Income	Proport'l tax (fr.) 18% rate	Surtax (fr.) (= total tax if p. tax not rate applied)	Combined tax (fr.) if p. tax rate is	Effective rate (%)	
					18% rate	9% not applied
S (no dep.)	200	34	10	0	34	10
M no chil.	"	34	10	0	34	10
M 2 chil.	"	24	7	0	24	7
M 4 chil.	"	0	0	0	0	0
S	300	54	34	12	66	46
M No chil.	"	54	34	0	54	34
M 2 chil.	"	44	24	0	44	24
M 4 chil.	"	14	0	0	14	0
S	1,500	90	72	40	130	112
M no chil.	"	90	72	12	102	84
M 2 chil.	"	80	62	0	80	62
M 4 chil.	"	50	32	0	50	32
S	1,000	180	162	145	325	307
M no chil.	"	180	162	79	259	241
M 2 chil.	"	170	152	46	216	198
M 4 chil.	"	140	122	24	164	146
S	3,000	540	522	895	1435	1417
M no chil.	"	540	522	589	1129	1111
M 2 chil.	"	530	512	434	964	946
M 4 chil.	"	500	482	338	838	820
S	5,000	900	882	1995	2895	2877
M no chil.	"	900	882	1389	2289	2271
M 2 chil.	"	890	872	1083	1973	1955
M 4 chil.	"	860	842	878	1738	1720
S	10,000	1800	1782	5345	7145	7127
M no chil.	"	1800	1782	3789	5589	5571
M 2 chil.	"	1790	1772	3185	4975	4957
M 4 chil.	"	1760	1742	2778	4538	4520

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Note to Table 3

The assumptions used in compiling this table were (a) that the total taxable income of each of these taxpayers was the same for both taxes (except in the cases where income was wholly exempted from the proportional tax, as shown), and (b) that the entire taxable income of each of these taxpayers fell into a single rate category under the proportional tax: either the 18%, or the 9% for the first 200,000 francs, or the totally exempted category.

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as the relative liberality of the interpretations of what constitutes taxable income and the degree to which income in each category tends to be underassessed. But in examining Table 3, one is particularly struck by certain aspects of the incidence of the personal income taxes.

(a) Income taxation can be extremely heavy on small incomes. This is because the proportional tax rate is relatively high while the reductions allowed for low incomes and dependents are extremely meagre. For instance, a married taxpayer with two children and taxable income of 200,000 francs (which is roughly \$570. a year and very small even in France), if he is not exempt from the proportional tax or entitled to the 9% rate, could be taxed 24,000 francs, or 12% of his taxable income if that income were accurately assessed. Even under the 9% rate he would be taxed 7,000 francs. Such a rate structure makes evasion in many cases essential to survival.

(b) At the other end of the scale, the top rates are reached at what seems a surprisingly modest level. The top, open-ended surtax bracket opens at 6 million francs, ^{11/} as com-

^{11/} Using the official exchange rate, this is roughly a \$17,000 pre-tax income. Actually, an income at or above this level is much rarer in France than in the United States. Nevertheless, such an income is certainly more modest by French standards than a \$200,000 income by ours.

pared with \$200,000 in our federal income tax. Effective rates are extremely high in the upper levels, especially for persons without dependents, as Table 3 shows. The bachelor with a 10 million franc income (\$29,000.) who is subject to both taxes falls under an effective 71% rate; with 20 million francs it would be 80%, with 30 million, 82%; in each of the latter

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cases, the last 10 million are taxed at 88% (18% proportional tax plus 70% surtax).

These first two aspects are explained by the fact that rising revenue requirements have prevented periodic revisions of the rate structure sufficient to offset the effects of the depreciation of the franc. The rates and low-income and dependency and relief provisions of the proportional tax have not in fact been changed since the 1948 reform. The surtax rates have been changed, but not enough to offset the monetary depreciation.

(c) Having children entitles one to relatively greater tax relief in France than under our federal income tax. Although the dependency reductions in the proportional tax are only significant for the poorer taxpayers, the advantage gained from income-splitting in the surtax increases with the size of the income.

(d) The 9% reduced rate under the proportional tax is only a significant advantage in the lower income brackets. (In most cases it merely reduces the proportional tax by a flat 18,000 francs, roughly \$50.). The total exemption from the proportional tax granted salary-earners, on the other hand, is a major benefit, since in general it amounts to an 18% reduction in the effective rate of the combined taxes. Were it not for the known underassessment of business profits and professional fees, one would conclude that these forms of income were heavily discriminated against (as is certainly true in the case of interest and dividends, underassessment of which is in general slight). The man on a salary, married

and with four dependent children, whose income consists entirely of his salary, on a taxable income of 3 million francs (\$8,500.) pays 338,000 francs in taxes, or 11% of that income. The man with the same number of dependents and with an assessed taxable income of the same amount but consisting of business profits or of dividends, pays 838,000 francs in taxes, or 28% of his income. The professional man in the same position, benefitting from the 9% rate on the first 200,000 francs, pays 820,000 francs, or 27% in taxes.

B. The Corporate Income Tax.

This tax is actually more than a tax on corporations; it is levied on a variety of types of business association having legal personality of which the true corporation (société anonyme) is only one example. Of the 161 thousand enterprises subjected to this tax in 1950, 133 thousand were limited-liability companies (sociétés à responsabilité limitée) and 21 thousand were corporations; the remainder took various other forms.

Enterprises subject to the corporate tax do not also pay the personal taxes, but distributed earnings are taxed both to the company and to the recipient of the dividends and interest, as in this country. The rate of the tax is currently 34%. Although comparison between the rates of different countries' taxes is hazardous, it can probably be said that while large companies are currently taxed somewhat more heavily today under our federal corporate tax than are large French companies, the smaller French companies, benefitting from no such reduced rate for smallness as our tax allows, are more heavily taxed than their American counterparts.

Assessment under the corporate tax is by verified

declaration. On the whole, the companies subject to this tax have fewer possibilities of successful evasion than do the enterprises whose earnings are taxed under the personal income taxes. As will be stressed below, however, business enterprises in both categories are probably able to escape a considerable part of the ultimate incidence by passing the tax on to consumers.

III. The Sales Taxes.

France has two national sales taxes, known as the production and transactions taxes, and a local sales tax known as the local additional tax, which is similar to the transactions tax.

The production tax is, from a revenue-producing viewpoint, by far France's most important tax. In 1951 it alone produced 39% of all tax receipts. It is perhaps the most successful of French taxes in terms of popular acceptability and compliance. The main reason for its relative success seems to be that those who pay it originally are comparatively few in number, while its ultimate incidence falls mostly on the many consumers who are only dimly aware of paying it.

The very importance of the tax in the fiscal structure, however, gives to its continuing defects a major significance for the national economy.

Since the First World War, France has been a laboratory of sales tax experimentation. Ever since the adoption of this form of taxation, liberal political parties have attacked "taxes on consumption" as unjust and have urged their

abolition. Yet it is noteworthy that when these groups have been in power, they have in fact made no serious effort to act upon these convictions. The sales taxes have been too productive, and it has long been clear that, until the income taxes can be greatly improved, any effort to use them more extensively while abandoning or reducing the importance of the sales taxes would result in a more inequitable tax system than France has today.

A. The Production Tax.

The production tax was established in 1936 to replace a general turnover tax and a number of special excises appended to it. The turnover tax, levied on virtually all commercial transactions, had proved to have a number of disadvantages. Perhaps the most serious was that the total tax included in the price of a commodity varied according to the number of transactions through which it (or its constituent parts) had passed. The result was a quite arbitrary tax discrimination between competitive products. The aims of the 1936 reform were to eliminate this cumulative aspect of the tax, and also to remove the necessity for collecting a sales tax from innumerable small retailers. Even when they were able to pass on the entire tax to consumers, most small retailers tended to make dishonest declarations, which were, however, extremely difficult to verify.

From 1936 to 1948, the production tax was levied only once with respect to each commodity, on the occasion of its sale by the last firm to perform an "act of production" on it. Since 1948, every firm performing "acts of production" on a commodity

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must pay a tax on its receipt from selling it. But each such "producer" is allowed to deduct, from the gross tax calculated on the commodity's value, those production taxes which he can show have already been paid on the commodity or its constituent materials by his suppliers, which taxes have been shifted on to him. The production tax is thus a limited version of a "tax on value added", since the tax each firm pays on a commodity sold is in fact based on its contribution to that commodity's value. Under this system, the total size of the tax included in the final price of an item does not vary according to the number of hands through which it has passed.

The basic rate of the production tax for commodities is 15.35%. Services (by garages, laundries, restaurants, etc.) are subject to a 5.8% rate. Certain commodities and services are not covered by the tax, in general because they are basic elements in household budgets. The most important of these are virtually all unprocessed foods (except meat) and many slightly processed foods. Certain other commodities benefit from a reduced rate (6.35%) for similar reasons.

Perhaps the principal merit of the production tax is that it can be relatively well enforced. A major reason for this is the provision for the deductibility of previous taxes paid. If a producer wishes to avoid legal liability for a tax on the full value of an item sold by him, he must be able to establish his right to deduct taxes paid by his suppliers and shifted onto him. To support deductions claimed he must be able to produce purchase vouchers in which his suppliers

have certified that they have paid production taxes and included these in the price charged to him. The availability of these purchase vouchers gives the tax authorities an invaluable means of checking on the taxes actually paid by producers. It also makes it possible for the authorities to verify the income tax declarations of producers far more effectively than they ever succeed in doing with distributors.

The principal technical defect of the production tax is that, while the cumulative effect of a turnover tax is avoided with respect to materials physically included in a commodity, there is no deduction allowed of taxes paid by producers on tools and machinery, office equipment, and a variety of other commodity and service expenditures whose amortization must be included in the price of consumer goods. The failure to make taxes on capital equipment deductible (or simply to exempt such equipment from the production tax) constitutes a deterrent to technical innovations, a discrimination against machine production in favor of handicrafts. In a country struggling to overcome the economic disadvantages resulting from high production costs and inefficient business practices, this fiscal discrimination against modernization is singularly unfortunate.

B. The Transactions Tax; the Local Additional Tax.

Although the production tax enacted in 1936 was supposed to put an end to the use of turnover taxes, in 1939 the need for new revenues for the war effort caused the enactment of a new turnover tax, which has never since been eliminated. It is now called the transactions tax, its basic rate is 1%, and

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it is levied on nearly all commodity and service transactions. Although subject to much evasion, especially by retailers, it nevertheless produced almost 10% of the central government's tax receipts in 1951. One feature of this tax worth noting is a special raised rate (1.8%) applicable to the sales of chain stores and establishments doing both a retail and whole-sale business.

The most important single source of local government tax revenue is the local additional tax, which is in most respects similar to the transactions tax. Its basic rate is 1.5%, with a special raised rate of 2.7%. The local governments have limited authority to raise these rates above the levels established in the Tax Code. Unlike the transactions tax, the local tax is not levied on commodity transactions subject to the production tax.

Exemptions from the transactions and local taxes are considerably more limited than those provided under the production tax. In its current effort to reduce the prices of key consumer goods, the Laniel Government is arranging to exempt a number of food items now subject to these taxes.

C. Proposals for Sales Tax Reform.

For a number of years, reform of the sales tax has been much discussed. The Pinay tax reform bill of 1952 contained a comprehensive reform plan. The bill was never voted on, but it seems likely that some reform of the sales taxes along the lines proposed in it will be enacted sooner or later. The Pinay proposal was that the production and transactions taxes should be combined into a "single tax on value added", with a rate of perhaps 20%. The tax would apply to the "value added" not only by all producers

but also by wholesalers and perhaps even retailers. At least partial deduction of taxes levied on tools, machinery, office equipment, etc., would be permitted. The present local tax would be converted into a retail sales tax.

IV. A Critical Appraisal of the System.

A. Perspective

Much of the current popular writing in France about French taxes is polemical, emotional, and derogatory. Much of what has been written on the subject outside France also tends to be derogatory. As in other fields of social and economic observation, French commentators seem to be leading the way in bitter, sometimes despairing criticism of French national institutions and habits. Foreigners inevitably tend to accept this evaluation, and to express criticisms which are often complacent when they are not biting.

It is not intended here to attempt a defense of French taxation. The defects of the system are undeniably grave. Nevertheless, some of the points being made against it are misdirected or at least overstated. It must also be remembered that the nature and operation of French fiscal institutions are to a large extent determined by the course and current status of France's political, social and economic evolution, which evolution provides a much more satisfactory explanation of the weaknesses of the tax system than does the idea too often expressed that the French are decadent, or at any rate constitutionally unable as a nation to maintain an effective tax system.

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Much stress is placed, in all current writing on French taxes, on the extent of evasion. Evasion is indeed a serious problem. Its causes, extent and the difficulties in eliminating it are discussed hereafter. The tone taken in many articles on the subject of French tax fraud may, however, leave readers with the quite erroneous impression that French evasion is almost unique in nature and magnitude. In fact, even in the Anglo-Saxon countries, where the level of civic conscience is perhaps the highest, some taxes are widely evaded (witness the personal property taxes in many American states). In many of the other countries of the world, tax morality (and also "tax literacy") are recognized to be so low that the more discriminating modern tax devices, such as the income tax, are relied on scarcely if at all.

The fact remains, of course, that the amount of revenue lost in France because of tax fraud has serious consequences for the national welfare. As already pointed out, however, the total of taxes actually collected represents a heavy burden on the economy. Greatly improved collections would in the long run probably not result in a much higher level of tax receipts but rather in a distribution of the burden, with a number of the rates lower than they are now. To say that "the French don't pay taxes", then, is wide of the mark: the point is that some Frenchmen don't pay their fair share, so that others must be overtaxed to make up for it.

Popular discussions of French tax evasion inevitably stress the alleged undertaxation of the rich, with a tendency to suggest that they are the principal beneficiaries of the system's defects. This too is a distortion of the truth.

Taxes being high and tax morality low in France, most rich people do their best to pay as little as possible. Certain of them - the relatively few rich farmers, some of the best-paid professional men, the comparatively few businessmen who have opportunities for concealing assets abroad, and the cleverest of those whose wealth has been illegally obtained - undoubtedly pay far less than they should. Wealthy Frenchmen, like some wealthy Americans, also do their best (with some success) to keep ahead of the tax authorities in inventing methods of avoiding taxes. But the taxes which fall on well-to-do Frenchmen are heavy, and some of them (e.g. the taxes on income from securities and on corporate earnings) are relatively well enforced. Furthermore, a considerable portion of the attentions of the tax administration is devoted to investigating well-to-do taxpayers, partly because their evasion is the most shocking and inexcusable but mostly because such investigations are apt to be the most rewarding in terms of manhours of investigative effort expended.

To which it must be added that since large incomes constitute an extremely small proportion of the aggregate of incomes in France, far less revenue is lost because of the considerable amount of fraud by the rich than is lost because of evasion by the owners of small and medium-sized enterprises and because of the fiscal privileges granted to farmers.

Another inaccurate statement often made is that the tax system as a whole is regressive, i.e. taxes the poor proportionally more heavily than the rich. A study of 1946 tax receipts (discussed below) indicates that the system in that

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year was in fact progressive in its incidence. A variant on the above allegation is the statement that workers and other employees pay nearly all the taxes. It may well be true that employed persons are today relatively overtaxed as a group, but it certainly is much less true than it was before 1948, when the proportional tax exemption, for wages and salaries was granted. The incidence of the sales and excise taxes on low incomes is also less heavy than is often assumed, because of the tendency to take account of the relative importance of the various goods and services in the budgets of low income families in determining which to tax and at what rates.

Many of what seem to us peculiar and unfortunate features of the French system have their close counterparts in other countries which are faced with similar institutional problems. Rarely is the explanation of a French tax provision which to us seems unsatisfactory to be found merely in unawareness that alternatives exist. Most tax provisions have their raison d'être in France's history, in the stage which French industrial, agricultural and commercial evolution has attained, in financial and accounting practices, in the state of civic spirit and the balance of political forces.

The following are a few aspects of the French institutional setting which are relevant to the tax system.

(a) A far larger proportion of the population of France consists of farmers and small businessmen than is true in the United States. As has already been pointed out, these groups, together with the liberal professions, present a taxation

problem in all countries.

(b) The use of the corporate form of business enterprise, of bank deposits, of highly formalized accounting practices, factors which greatly increase the ease of tax administration, are much less extensive in France than in the United States.

(c) French business is characterized by the prolonged existence of many firms which in a truly competitive economy would not survive. Government, labor, and even the more efficient business units tacitly conspire to keep these firms afloat. One form of protection they receive, as will be described below, comes from discriminatory tax provisions (some relieving them, some penalizing the more efficient business practices), coupled with a hesitancy to push vigorously those enforcement measures which would reduce their tax evasion. The reluctance of efficient firms to push competitive advantages, indeed the frequent practice of collusive price-setting, also facilitate the shifting to consumers of taxes on business profits.

(d) The relations of Frenchmen with their tax officials differ from those between American taxpayers and tax agents. While we have come to accept the investigatory powers entrusted to tax agents as a necessary evil, and on the whole tend to trust the honesty and discretion of the agents, the French public and parliament alike are far from accepting the principle that fiscal needs should prevail over the right to privacy. Indeed, the scope of the whole concept of "business secrets" tends to be much wider in France than it now is in this country.

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(e) The whole atmosphere of relationships between government and citizen is different in France from what we are familiar with. A considerable segment of the population oppose the whole regime, its democratic or its capitalistic aspects or both (e.g., Communists, extreme Rightists); many other groups are normally hostile to the government and consider it hostile to them (e.g., most non-Communist workers, and many businessmen and farmers). Even among many of those not falling into these categories one finds a lack of enthusiasm, loyalty or even respect for public figures, institutions, and symbols. There prevails among Frenchmen a concept of the relation of the individual to the community which, except in times of crisis, places the individual's duty to society well behind his obligation to the family and his right to strive for expression of his personality. The weakness of civic spirit, of social cohesion, inevitably results in a low level of tax morality.

To say that criticisms of the French tax system have often overshot the mark, and that there are historical and environmental explanations for many of its characteristics, is not to absolve it from criticism. The system is working extremely badly today when heavy demands are being made on it and heavier may come. Although taxation might be being used to direct and accelerate desirable change, its influence now operates mostly to perpetuate characteristics of the French economy which must change if France is to play the role she has set for herself in the world.

B. Complexity of the Tax System and Frequency of Change.

Probably and tax system which absorbs as much revenue in proportion to gross national product as does the French system must utilize a wide variety of fiscal devices, if only to mitigate the detrimental effects which any single tax is bound to have if applied too intensively. Nevertheless, despite major amputations in recent years, the French system is still probably too complex to be administered with maximum efficiency.

More serious than the number of taxes, however, is the lack of consistency and logic. The system is a patchwork, having evolved more in response to special situations and pressures than to a central plan or concept. This characteristic sometimes produces unfair and economically detrimental results, as when easily assessed tax bases are utilized for a whole series of taxes without adequate regard for the aggregate burden thereby imposed. The frequency of fiscal tinkering also has a bad effect: the advantages of familiarity and certainty, which tend to lessen hostility to unpopular taxes, are largely sacrificed. All too many exceptional one-time levies, entailing wasteful diversion of administrative attention from the enforcement of the permanent taxes, have been employed. Complexity, constant changes, the use of exceptional levies, and the absence of a unifying logic have all resulted in the system's being inconvenient for taxpayers and difficult for the tax authorities to administer efficiently.

Also, as general principles and uniformity of treatment disappear, the temptation to grant exceptional treatment be-

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comes harder to resist. There have been all too many special exemptions, deductions and reduced rates to promote or protect favored activities. Some of the concessions made have economic merit; many have not, merely representing surrenders to political pressure.

C. Inequities in the Tax System

1. Is the system as a whole progressive? The overall progressivity of a tax system has come to be generally accepted as the first test of its fairness. Most people now agree that, since in general the larger a man's income the less urgently does he need each additional increment to it, it is fair to provide that the proportion of tax burden to income shall increase with size of income (some account being taken of number of dependents and a few other special circumstances). Not all the tax devices which governments have to use to obtain revenue can be progressive; the progressivity of the system as a whole is the objective to be sought, with the income taxes usually serving as the principal means of obtaining overall progressivity. (Indeed, a justification for relatively steep income tax progressivity may be the need to offset the effects of other taxes which are regressive.)

It is unfortunately not easy, even with such statistical materials as are available in the United States, to measure the overall progressivity of a tax system. A bold attempt has been made, however, to appraise the incidence of French

^{12/} taxes in 1946. Data for a later year would be preferable.
^{12/} H. Brochier, Finances publiques et redistribution des revenus (1950). As the title implies, this is a study not merely of tax incidence but of the total effect of government taxing, borrowing, spending and paying debt interest on the distribution of private incomes.

particularly in view of the changes in the tax structure since 1946, but it seems likely that the general conclusions of this study are still valid.

While the incidence of taxation varies widely for different categories of income, the author concludes that in 1946 the system as a whole was mildly progressive. Even the consumption taxes were in the aggregate slightly progressive, he thinks, as a result of the exemption of basic foods and the exceptionally heavy levies on certain non-essentials. He notes, however, that if receipts from certain exceptional levies collected in 1946 are excluded from the calculation, the progressivity flattens out markedly for the top income brackets.

M. Brochier emphasizes the remarkably large proportion of the total of private incomes going to those with small (100,000 francs or less) and medium (500,000 francs or less) incomes. There are (appearances to the contrary) so few really high incomes to be taxed in France that no tax system can obtain enough revenue from the rich to avoid the necessity of relatively heavy taxation of the lower incomes.

Although it transcends in scope the subject of taxation, M. Brochier's final conclusion is of particular interest. One tends to assume that in a State with progressive taxation and ^{13/}comprehensive social security, the total effect of govern-
13/ Social security and family allowance benefits are here
treated as government expenditures - just as above payments to the benefit funds were treated as the equivalent of taxes - despite the fact that the social security system is administratively semi-autonomous. Payments and benefits are obligations created by government to achieve public objectives along lines prescribed by (and closely supervised by) government.

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ment taxing and spending is to effect at least some redistribution of income from the richer to the poorer segments of the population. This is not so in France, says M. Brochier. The low-income segment of the population in 1946 paid more in taxes than it obtained in benefits from government spending, while the high-income segment paid less than it received. A considerably more progressive tax system (and a more progressive system of financing social security benefits) than France now has would be necessary if it were desired to achieve a redistribution of income from rich to poor by means of changes in the tax system - and much greater progressivity would probably be economically unwise even if it were politically feasible. ^{12/}

14/ The explanation given by M. Brochier why public finances today tend to redistribute incomes as they do cannot be discussed here. It should be said that he emphasizes changes in the pattern of public expenditure as the best means of redistributing incomes from rich to poor if that objective should be adopted in France.

2. Privilege and fraud. The fact that the tax system is progressive by no means makes it equitable. As has already been indicated, there is in fact little uniformity of correlation between the "ability to pay" of French taxpayers and the tax burden which they bear. The most important reasons for this are (a) that some categories of taxpayers benefit from legislative discrimination in their favor, and (b) that some groups are able to evade and avoid taxes much better than others.

There are numerous examples of legislative discrimination in the Tax Code. But the case of farmers is outstanding.

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Of somewhat over 2 million farm families in France, a large majority subsists on tiny landholdings and doubtless earns too little to be taxable under any reasonable income tax. But only 53,000 farm families paid any progressive surtax at all in 1951; the income taxed of these was only 15.2 billion francs, or 1% of the total taxable income subjected to the surtax. The 516,000 farmers who paid the proportional tax (the basic and dependency exemption provisions of which are considerably lower than for the surtax) were taxed on only 71.5 billion francs of taxable income, or an average of less than 140,000 francs a year of farm income per family taxed. Yet farm income in 1951 has been estimated, on the basis of value of products, as totalling somewhat over 1,000 billion francs. Clearly, even making generous allowance for the sum of the incomes of farmers whose low incomes entitled them not to pay any tax and for personal and family disassessments, farmers as a group were taxed under the proportional tax on only a minor fraction of their actual incomes.

In the Report on the Provisional National Accounts for 1951, revenue lost in 1951 because of the special treatment of farmers under the income tax is estimated at 65 billion francs: 50 billion under the proportional tax and 15 billion under the surtax. Farm income actually subjected to tax is estimated as being somewhere between 10 and 20 percent of potentially taxable farm income. (This is in contrast to the industrial and commercial sectors, for which it is estimated that roughly 80 and 72 percent, respectively, of potentially taxable income were actually taxed in 1949.) Furthermore, exemption from the payroll-pensions tax, special

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exemptions under the alcohol tax and the exemption from the transactions taxes of farm produce consumed on the farm are estimated to have cost the state 38 billion francs more.

This brings the total cost of farmers' tax privileges to slightly over 100 billion francs.^{15/}

15/ Rapports sur les comptes provisoires, p. 61.

No satisfactory means exists for calculating with any precision the revenue lost because of tax fraud. Recent estimates have varied from 300 billion to 1,000 billion francs a year, which for 1951 would have represented a range between 13 and 42% of total taxes collected. The amount of fraud has certainly increased with the growth of the total tax burden.

While few French taxes are evasion-proof, the problem is most serious with respect to the income taxes. Roughly half the revenue lost can probably be attributed to income tax evasion.^{16/} As already noted, this evasion is most serious

16/ Fraud and fiscal privileges together are estimated to reduce the yield of the income taxes by more than 40%; ibid., p.99.

among the unincorporated enterprises subject to the personal income taxes and among the liberal professions. While the legislative discrimination in favor of farmers favors the big farmers most - with most small farmers too poor to be taxable under any income tax, the prosperous farmers are the real beneficiaries of the extraordinarily favorable assessment system - the failure to eliminate tax fraud in industry and commerce results in benefits which are distributed in inverse proportion to the size of enterprise. The Report on

the Provisional National Accounts for 1951 contains the following illustrative estimates:

Fraud as % of Declared Profits in 1950, by Size of Firm
(based on investigated declarations)

<u>Annual Business turnover</u>	<u>Corp. Tax</u>	<u>Prop't'l tax</u>
over 200 million francs	25%	35%
20-200 " "	30%	45%
7-20 " "	65%	60%
less than 7 " "	110%	80%
weighted average	30%	57%

In general, there is more fraud among commercial and service enterprises than among producers; this is in considerable part due to the technical efficacy of the production tax, the assessment of which provides the tax administration with information valuable for the enforcement of several other taxes.^{17/}

Estimates of Undeclared Gross Receipts and Net Income
in 1949

	<u>Gross Receipts</u>			<u>Net income</u>		
	<u>Actual</u> (bill.fr.)	<u>Untaxed</u> (b.fr.)	<u>% of</u> <u>fraud</u>	<u>Actual</u> (b.fr.)	<u>Untaxed</u>	<u>% of</u> <u>fraud</u>
Industry, transport, public w'ks	8000	310	3.9	810	160	19.7
Commerce, Services, liberal professions	7200	800	11.1	780	220	28.3
Totals	15,200	1110	—	1590	380	—

^{17/} Ibid., pp.62-64.

3. Problems of enforcement. Some of the practical difficulties of eliminating tax fraud have been alluded to. The task is far too big for the staff available. Parliamentary distrust and public hostility have long hindered effective investigation. The fact that evasion is so widespread and

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subject to so little social censure makes it much harder for the authorities to "make an example" of a wrongdoer; the unlucky victim is considered by his colleagues and his representative in parliament to be harshly treated, since he has only been doing what everybody else in his position has done.

The arsenal of sanctions seems on the whole to be adequate; fines can be extremely severe, and it is entirely possible to send a tax delinquent to jail. Until recently, however, the more severe penalties were rarely invoked, and even now heavy penalty payments are apparently preferred to court proceedings and a possible jail sentence.

An enforcement drive is currently (September 1953) underway, with much press publicity concerning the delinquents brought to heel. As one might expect, the cases reported tend to be of the sensational sort: most often they involve rich men whose assets abroad have been revealed or whose ownership of chateaux, automobiles or yachts has at least come to the attention of the authorities. The indications are that investigation will as always be largely confined to the tax status of the well-to-do, with little attempt being made to penetrate the jungle of small business evasion. This is certainly easy to understand. Efforts to uncover fraud among small firms are bound to be relatively unremunerative in terms of extra revenues obtained per manhour spent. Furthermore, the actual collection of taxes due from many small marginal enterprises (to say nothing of penalty payments) would probably put many of them out of business. The economist may say that the elimination of these inefficient economic units is necessary if national productivity is to rise, but the tax

official and the politician naturally hesitate to envisage measures which will lead to this result. On the other hand, there can be no doubt that failure to search out evaders among small businessmen perpetuates the fraudulent proclivities of this category of taxpayer and feeds the cynicism of other taxpayers.

A marked improvement in overall tax enforcement has been achieved in recent years. The tax administration has been reorganized, the number of tax agents has increased, investigatory procedures have improved, central records on taxpayers are better organized, and penalties have become more severe and are more readily used. Examples are being made: a number of evaders have been sent to prison. Cries of "Inquisition!" are being heard in parliament and the Right-wing press, which is undoubtedly a good sign. Additional taxes collected plus penalties are said to have totalled as high as 100 billion francs in 1951; 160 billion were anticipated for 1952. In particular, the larger firms, where fraud almost inevitably involves the complicity of employees and deception of some associates or of stockholders, are finding evasion increasingly difficult, and the consequences of detection more severe.

From time to time in the past, the French government has made use of the fiscal amnesty. This has involved the government's undertaking not to prosecute persons who voluntarily regularized their position by paying up their back taxes

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due. Amnesties have on occasion served to bring in considerable revenue which might otherwise not have been obtained and to clear the boards for concentrated action against those who have not responded to the opportunity.

The Pinay Government in the spring of 1952 obtained enactment of a fiscal amnesty more generous than ever before. Past delinquencies not already being prosecuted would be forgiven, with neither back taxes nor fines payable, provided only that the ill-gotten gains be invested before July 1, 1952. No questions would be asked concerning the source of funds invested before that date; thereafter, persons found with funds which had not been declared as required for tax purposes would have to prove that such funds were entitled nevertheless to benefit from the amnesty. Taxpayers were told that this was their last chance, that uninvested funds and new evasions would be tracked down and the delinquents punished more severely than ever before.

The psychological soundness of this effort to "restore confidence" and to redeem reluctant tax evaders was seriously questioned by many at the time, as was the moral rightness of forgiving the delinquents without even making them pay up what they owed. The opinion of some experts in retrospect has been that the measure was not only perhaps unwise but also badly implemented; the administrative regulations are said not to have anticipated nor where possible provided for many of the circumstances which would deter delinquent taxpayers from taking advantage of the amnesty.

D. The Influence of Taxes on the Economic Structure.

Since virtually every tax levied has economic consequences, there is much which might be said under this heading. The brief observations which follow are confined to a single aspect of the economic effect of French taxation which seems particularly important.

It has already been suggested that the present state of French taxation can largely be explained in terms of political, economic and social developments in the French past. One can also say that the tax system as it stands tends to protect and perpetuate the prevailing national economic institutions and habits. This would be normal and satisfactory were it not that French leaders and many elements of French society have come to recognize that France cannot fulfill the role they envision for her, as an industrial nation, a participant in world trade, a force in world politics, and most importantly, as a functioning democratic society providing its members with the standard of living they expect, unless the old patterns are radically altered. The tax system must contribute to the accelerated evolution which these objectives require rather than deter it.

France is notoriously a country of small enterprises. Many of these are not economically viable, and in a truly competitive environment would not survive. To some classes of French people it is of great importance not to be "proletarianized"; these people would rather eke out a precarious livelihood in a tiny establishment of their own than be employees. Society conspires to make this possible even though the economy would undoubtedly gain by the elimination of many

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of these marginal units. The tax system plays its part in this form of protectionism in a number of ways.

An example is the discrimination in favor of artisanal enterprises. An artisan is defined in the law as a producer or supplier of services whose work is principally manual, involving few tools and only the simplest selling facilities, and who is aided only by members of his immediate family, one assistant and one apprentice of less than 18 years of age. Artisans benefit from the 9% reduced rate under the proportional income tax, are exempt from the production tax, and also from the local business tax. The result of the discrimination in their favor has been a large increase in the number of enterprises calling themselves artisanal, often representing the fictitious splitting up of larger units with a view to obtaining the tax relief. The effect of the provisions concerning artisans is to protect and encourage inefficient operations on an excessively small scale, and to discourage small operators from improving their methods unless certain that the resultant gain will more than offset the loss of their tax advantages.

Among other examples of discrimination in favor of the small and all too often inefficient units are various provisions penalizing bigness and economic integration. The special raised rates of the transactions and local taxes applicable to retail enterprises which also do a substantial wholesale business, and to the branch establishments of retail enterprises, are examples. Another provision of the transactions tax lessens the advantages of organized group

purchasing by merchants, by specifying that the transfers of goods between the group organizations and their members are taxable transactions. The local business tax discriminates against bigness in general, and specifically against chain-stores. The production tax discriminates against machine production because the tax is in effect levied twice on capital equipment (see above). The income tax provisions against bigness.

Certainly the most important element of tax discrimination in favor of small enterprises, however, is the continued failure of the government to take steps to improve assessment methods and reduce fraud except among the larger enterprises. It is often pointed out, for instance, that many small and inefficient firms are able to keep afloat on the turnover tax receipts which they collect from the customers but do not pay over to the authorities. This form of fraud, which often constitutes a substantial proportion of such firms' receipts, gives them an artificial advantage over larger establishments which cannot evade.

The classic case of a fiscal favorite is the farmer. Spokesmen for the French farmers argue that their situation is unique. Farming, they contend, is so rigorous, so hazardous, and so unremunerative an occupation that the countryside is rapidly being depopulated. On the maintaining of a thriving farm population, they say, depends the economic safety, the political stability and ultimately the future of the democratic regime in France. Hence tariffs, public expenditures, and tax burden apportionment all must be directed toward minimizing the disadvantages of agriculture.

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Many students of the French economy would reply that French farmers have in fact been protected and favored for most of the past century, and that this policy has not only failed to arrest the "flight from the land", but has largely contributed to the relative backwardness of French agriculture, now well behind that of most of its neighbors in productivity. With respect to the recognized poverty of many farmers, they would argue that the basic and family exemptions and related groups should be sufficient to protect farmers, especially if (as is likely) farm income in kind remains exempt from taxation. As for the economic risks of farming, these are greatly diminished nowadays by the price support programs. Lastly, they would ask why the prosperous farmers - and many farmers became wealthy during the Occupation and in the post-war period of scarcities - should be allowed to benefit from tax relief allegedly required for the sake of the subsistence-level farmers.

Whatever one's beliefs may be as to the special situation of agriculture, it is difficult to avoid the conclusion that tax relief of the form and magnitude now granted is not justifiable on grounds either of equity or of economics. If farmers are to be subsidized to enable them to invest more extensively in modern equipment, the subsidy should take the form of loans granted for specific purposes, not of tax dispensations which in fact reduce rather than add to the incentives to modernize. Once the taxation of farmers has reached a level where they are bearing their approximate share of the tax burden, it may be possible to build into the system in-

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centives to encourage low-cost, high-productivity-per-hectare operations.

E. Limits to Further Tax Increases

The period since the end of the war has been marked by almost continuous inflation in France. The causes of that inflation need not be discussed here, but certainly the chronic budgetary deficit has usually been one of them. For the present, overall price stability prevails and there are even signs of a recession in some sectors, but France's leaders continue to be preoccupied with the size and potentially inflationary impact of the deficit, which is estimated at over 700 billion francs for 1953, and likely to be larger next year unless vigorous measures are taken to prevent it. ^{18/}

^{18/} This section is preoccupied with the problem of inflation (which has been called the unfairer tax of all) and with the influence of the deficit on inflation. There are institutional and psychological obstacles to continued large-scale deficits in France under any conditions, but it is mostly because of the inflationary outbreaks which so often recur in France, and which have been so particularly virulent in the post-war period, that the deficit is important. Some economists feel that the danger of inflation is over in France for the time being. If they are right, it may be that reducing the deficit is less important than administering stimulants. The assumption herein is that the danger of renewed inflation is still very real.

Obviously one way to close a budgetary deficit is to raise taxes. For several years previous to 1952, the real tax burden rose steadily: this was due partly to the higher effective rates which became applicable as national income rose and partly to improved enforcement but also to a number of important rate increases. Early in 1952, two successive Governments which ventured to recommend new rate increases (those of MM. Plevin and Faure) fell, in considerable part because of their tax proposals. The two subsequent Govern-

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ments, those of MM. Pinay and Mayer, despite growing expenditures and Treasury difficulties in meeting current obligations, cautiously refrained from asking for tax increases of any significance and took care to insist that the tax reforms which they proposed would not involved higher taxes. M. Laniel obtained parliamentary consent to moderate increases in the alcohol, oil product, and stamp taxes only in order to meet a special Treasury emergency. Indeed, no political leader, as this is written (September 1953), seems inclined to say that there should be new increases in the major taxes, despite disappointing yields recently as a result of the business stagnation.

Before considering whether in fact some sort of tax ceiling has been reached, alternative solutions to the problem of the deficit should be examined.

In 1951, public expenditures (including social security benefits) constituted almost one-half of net national income, as compared with just over 30% in 1938. The component elements were as follows (in percentages of national income):^{19/}

19/ Rapports sur les comptes provisoires, p. 41.

	<u>1938</u>	<u>1951</u>
Military	3.3	9.2
Civil government	8.4	11.8
Transfer payments	13.5	18.6
(of which social Security)	(1.4)	(10.1)
Economic subsidies,		
investment, reconstruction	0.8	7.5
	<u>31.0</u>	<u>47.1</u>

It is, of course, because the role of public expenditures in the economy has expanded so much that revenues have had to be

increased so greatly. That obtaining the revenues needed has created problems is not surprising. It is not true, as one might think, that just because most of the payments to the State come back to the taxpayers in one way or another through expenditure, the raising of taxes and other exactions need create no great difficulties. Regardless of what he may gain from the government's expenditures, each citizen's habits, morals and economic incentives are affected by his efforts to adjust to the heavier exactions.

Can substantial reductions be made in any of these expenditures? This question has two aspects: (1) Can any entire programs of government spending activity be abandoned or greatly curtailed? (2) If not, what are the possibilities of economies in existing programs?

(1) It is sometimes contended that the State should reduce its commitments in the fields of investment and social security. It may well be true that for a government to assume as large a role in the national economic life as that of the French government has important disadvantages. But the alternatives must be considered. If the State did not finance Monnet Plan investment, it would have to be financed by the investing enterprises. Unless they could finance their projects by selling bonds to the public (which has not to date been possible on the scale required because of the insufficiency of savings available for investment), they would have to raise the prices of their products (coal, steel, electricity, etc.) to cover investment, which would have an inflationary impact comparable to that of public expenditure unmatched by receipts. Similarly, if the State did not pro-

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vide for social security and family allowance benefits, either employers would adopt their own social security systems or wages would rise.^{20/} Here again the inflationary significance

^{20/} Statistics show that as benefits have risen, real wages have declined; wages-plus-benefits today are roughly the same proportion of national income as wages alone before the war, when benefits were negligible. It is here assumed that employers would recognize the necessity of compensating immediately and in full for any curtailment of benefits.

of the expenditure would not be changed by the shift. Of course, there is another set of alternatives; the investment projects could be abandoned altogether and the already low standard of living of employees allowed to drop, but the consequences of these choices are certainly too serious to envisage.

In other words, although there may be good reasons for the State's gradual retirement from these activities, the argument that by its doing so and thus reducing the level of public expenditure an important contribution is made to the problem of inflation is not a sound one. It should be added that a major change in the State's role with respect to investment and social security seems neither likely or desirable for the present.

The other sector in which major changes in program might conceivably be possible is military expenditure. A growing number of Frenchmen are saying that France must reduce her military commitments. This may happen, but if it does it is not at all certain that the results for France and the world may not be catastrophic. From a strategic point of

view, French military expenditure may if anything be inadequate. In any case, major reductions in the military budget do not seem likely in the near future.

(2) Assuming, then that no elimination or heavy curtailment of major expenditure programs is to be expected, the next question is whether there are economies to be made in the existing programs. No budget exists that does not contain some items which could be dispensed with, but pressure to cut expenses in France has been so unceasing over the past few years that what is left is apt to be either really indispensable or of rock-bound political impregnability. Furthermore, as each new budget is drawn up, the Government must decide whether important programs which year after year have been put off or allotted wholly inadequate amounts can be neglected once more. The pressure to increase expenditures more than balances the pressure to reduce them.

When an item is found which should be reduced in the interest of economy, the parliamentary resistance or the outcry of the affected group is often so formidable that no action is possible. If there is no parliamentary majority prepared to support tax increases, neither does there seem to be a majority prepared to accept a substantial program of budgetary reductions.

It must be recognized, then, that the possibilities of reducing expenditures are limited; indeed, their predominant tendency is to increase. The other alternative to tax increases is borrowing from the public. That the present Government has hopes in this direction is attested by the recent announcement of the Finance Minister that much of the produc-

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tive investment hitherto financed by the government will henceforth be financed by bond issues offered by the investing enterprises. This would obviously be a desirable alternative to budgetary financing; the only question is whether the capital will be forthcoming. The indifferent success of the much-publicized Pinay loan of 1952, with its unprecedentedly advantageous conditions, gives some cause for skepticism. At any rate, the Minister hastened to add that the amount of investment in the sectors concerned would not be allowed to decline; whatever is not covered by borrowing will be financed by the State as in the past.

For the present it is clear that the Government is counting on economies, borrowing and better tax enforcement (plus foreign aid) to keep the deficit down to manageable proportions. But it is possible that tax increases may have to be proposed again. What are the objections and the obstacles to such increases?

In the first place, it seems clear that the chances of getting significant tax increases through the parliament are slim under present circumstances. If anything, taxes may be slightly lowered; the Government has indicated its willingness to sponsor limited tax relief measures.

The economic objections to tax increases are:

(a) That taxes are already so heavy as to show signs of inhibiting business initiative and expansion. ^{21/}

21/ There is perhaps some tendency to exaggerate these effects, however. The protectionist, non-competitive tradition, and fears of war and of internal strife, are more important than high taxes in accounting for entrepreneurial lethargy.

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(b) That significantly higher taxes will inevitably raise the general price level, because taxes are so readily shifted. Already prices are so high as to cause serious balance-of-payments difficulties for France, because she cannot export enough to pay for necessary imports.

(c) That higher prices will intensify social injustice. In a country where purchasing power is abundant and fairly well distributed, the raising of taxes which enter into prices can be justified as an anti-inflationary measure. Where, as in France, large portions of the population live very poorly, the harm done by raising such taxes may outweigh the gain. If the result is a raise in wages, as it well might be now that France has a sliding-scale wage law attaching minimum wages to a cost-of-living index, the injustice would be temporarily relieved for many, but a new inflationary spiral might ensue.

On the other hand, there are unquestionably Frenchmen who should be contributing more in taxes to the community than they are. Increasing their contribution involves two main problems: assessing them accurately and imposing taxes which they cannot shift. The difficult problem of fair assessment, partly a question of legislative favoritism and partly of evasion, has been discussed. The shifting of taxes on business earnings can only be avoided by the development of real competition and the disappearance of those "seller's market" conditions which enable the businessman taxpayer to raise his prices at will. It may be that current business conditions are making it harder to shift the income taxes,

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so that higher taxes levied on now undertaxed business earnings would not necessarily be shifted to consumers.

Tax reform would seem to be a prerequisite to any substantial increase in tax rates. When a tax system is inequitable, when it has undesirable economic effects, then the higher the rates go, the more serious do those inequities and detrimental effects become. The damage being done by the present tax structure, in increasing the hostility between social groups, in corroding civic spirit and morality, and in penalizing efforts to achieve higher productivity in industry and commerce, is already serious. If tax increases are not to intensify the damage now being done, they must be preceded or accompanied by minimal basic reforms in the methods of securing accurate assessments and by the elimination of the worst instances of economically unwarranted discriminatory provisions. If such reforms were effectively formulated and vigorously implemented, it should be possible to increase revenues substantially without major increases in rates, and some tax relief for those now overtaxed might even be possible.

F. Reform Proposals.

A foreigner contemplating any one of France's many institutional problems should always beware of assuming (1) that the French do not realize that anything is wrong, or (2) that they have no precise notion of what the dimensions and significant aspects of the problem are, or (3) that they have no ideas as to what might be done about it.

Awareness of the defects of the French tax system is in fact widespread in France and there has been no dearth of tax reform proposals, by no means all of them motivated merely

by the selfish interests of their proponents. The lack of improvement in the tax situation is due not to the paucity of ideas to choose from but to a distribution of political forces which makes constructive action extremely difficult to achieve.

To describe and analyze the tax reform proposals currently being discussed in France would double the length of the present study. The purpose of this brief section is merely to give a general idea of some of the types of proposal being made.

Tax reform proposals might be divided into three categories. First, there are the projects emanating from Governments themselves and from committees appointed by Governments. Then there are the unofficial proposals for partial reforms of relatively limited scope. Lastly, there are the proposals for root-and-branch reforms involving changes throughout the whole tax system.

(1) A good example of the first type of reform proposal is the bill brought into the parliament by the Pinay Government late in 1952, mutilated by the Finance Committee of the lower house and finally withdrawn a few weeks before the fall of the Pinay Government.

The Pinay Government's bill, ^{22/} the first major reform

22/ No. 4579, Assemblée nationale, Année 1952, Projet de loi
portant réforme fiscale (1952).

project to come before the parliament since 1948, was the long-promised response to repeated demands from virtually all parties, as well as labor and business organizations, for new tax reform legislation. It was based on a report

drawn up by a specially named committee of experts. ^{23/} As soon

23/ Ministere des Finances, Service des etudes economiques et
financieres, Rapport general de la Commission de reforme fiscale
(the so-called Lorient Report.)

as the Government bill was published, however, there were outcries from all sides that this was no tax reform at all. Indeed, with the exception of the project replacing the two sales taxes with a single tax on value added, the bill contained few provisions which seemed to critical observers to constitute real progress toward remedying the defects of the existing legislation. Actually, however, the hostility shown to the Pinay Government's bill in the parliament was not due to its inadequacy, but to provisions which special interest groups recognized would result in somewhat higher levies on them.

The Mayer Government, having obtained the right to present tax reform decrees which would become law if not altered or rejected by the parliament within a given time, produced a reform project of more limited scope, of which the principal features were the value-added tax and the conversion of the progressive surtax to an eventual pay-as-you-go and partial withholding basis. Of these proposals, the latter was withdrawn by the Laniel Government in the face of strong parliamentary hostility, while the deadline date for action on the former has been pushed back. The present Government, not having obtained powers to promulgate tax reforms by decree, has promised in its turn to bring a tax reform bill before the parliament.

It seems likely that in the authority to promulgate reforms by decree under the sort of permissive legislation enacted for the Mayer Government lies the best hope for achieving changes of any significance. But the authority is granted reluctantly, and reforms by decree can easily be undone by the parliament, as was demonstrated with the 1948 reforms, a number of which have been effectively cancelled by subsequent parliamentary action.

(2) In the second category of reform proposals falls a great variety of unofficial projects for partial reform. It may perhaps be useful to point out an important cleavage between their proponents. On the one hand are those who take the attitude already described that voluntary self-assessment can never be made to work satisfactorily in France, both because declarations will never be honest and because enforcement methods of the rigor required will never be popularly acceptable. Therefore they favor impersonal, "scientific" assessment based on surveys of the earnings of representative economic units. The extended use of external signs of wealth for individuals and of such indicia for business firms as physical size of establishment, number of employees, etc., seems to find favor with a surprising number of critics. Some of these taking a pessimistic view go so far as to argue that income taxes simply cannot be made to work well in France, so that reform efforts should be concentrated on perfecting the consumption taxes. From the short-run viewpoint, at least, one can hardly criticize the pessimism on which these proposals are based. There are, however, more optimistic students of the tax system who feel that the income taxes

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can and must be made both more equitable and more productive. They are convinced that estimates systems of assessment will always produce inexact and arbitrary appraisals of real income, and that heavy consumption taxes will always cause the lower-income groups to bear more than their fair share of the tax burden.

One proposal which has aroused considerable interest is for a low-rate (perhaps 1%) tax on net worth. This tax might ultimately replace some of the other taxes on capital, mostly levied on property transfers. One of its principal advantages would be the information which its assessment would provide concerning sources of income.

(3) The root-and-branch reform proposals are distinguished from those just discussed not by being necessarily more visionary, but by their comprehensiveness. One type of root-and-branch reform is the single tax proposal. The notion of a single tax on the sources of energy has been the subject of a surprising amount of discussion, considering what appear to be its obvious weaknesses. More significant are a number of reform programs brought forth by trade-union groups. Of these one of the more interesting is that of the national union of government employees concerned with the administration of direct taxes.^{24/} To give an idea of the sort of pro-

^{24/} Commission d'études économiques, financières, fiscales et administratives du Syndicat national des cadres des contributions directes et du cadastre (F.O.), La réforme fiscale (1951). This booklet has the special merit of containing summaries of most of the other comprehensive reform proposals under public discussion in 1951.

posal for a root-and-branch reform which is now being discussed, this section concludes with a very brief summary of their proposal.

Most of the existing taxes, and the allowances for families, old workers and economically handicapped persons, would be abolished, and replaced by:

(a) A broad tax levied on the "value added" by all persons or firms selling goods or services (including agricultural goods and professional services), with a rate of between 25 and 35%.

(b) A proportional personal income tax (proposed rate 10%), possibly later to be supplemented by a proportional surtax on income above a certain level. There would be no basic exemptions or similar provisions, for reasons noted below. This tax would be levied on undistributed corporate earnings as well as on persons.

(c) A single tax on net worth (proposed rate 1%) to replace all other taxes on capital.

(d) A single local tax based largely on the benefit principle, on the assumption that local expenditures of common benefit would thenceforth be covered by the central government.

(e) A social allowance, designed to take the place of the present allowances for families, old workers and economically handicapped persons; to make possible the elimination of personal and family exemptions and income-splitting from the income tax; and to give the tax system a somewhat progressive character. Each Frenchman, adult or child, would be entitled to an allowance of something like 5,000 to 6,000

francs per month; this would ensure a minimum income to every member of society. Each family head would maintain a running account with his tax allowances due him and his tax obligations. He would make a payment to the collector or the collector would pay him at the end of each month, depending on how the balance of obligations stood. (Well-to-do people, would, of course, always be making payments while poor people would always be receiving them.)

The ambitiousness of this project is in striking contrast to the modest reforms being considered at the political level. There is, however, small likelihood of a comprehensive reform of this scope being enacted within the foreseeable future. Nor does this proposal, interesting though it is, seem to make any real contribution to solving the problem of assessing accurately the bases on which the taxes are to be levied.

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